



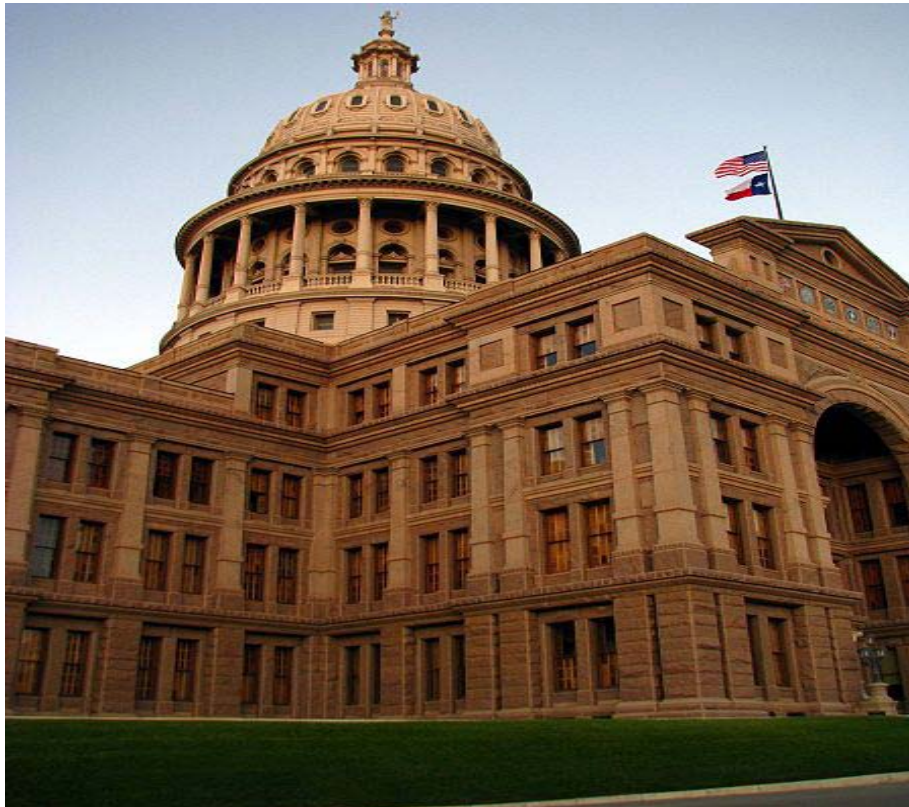
**U.S. Department of Education
Office of Inspector General**



American Recovery and Reinvestment Act of 2009

Systems of Internal Control Over Selected ARRA Funds in the State of Texas

Audit Report



Texas State Capitol Building

ED-OIG/A06J0013

JANUARY 2010

Acronyms/Abbreviations Used in this Report

ARRA	American Recovery and Reinvestment Act of 2009
C.F.R.	Code of Federal Regulations
Cleburne	Cleburne Independent School District
DARS	Texas Department of Assistive and Rehabilitative Services
DISD	Dallas Independent School District
Department	U.S. Department of Education
Fort Bend	Fort Bend Independent School District
Governor's Office	State of Texas Governor's Office
IDEA	Part B of the Individuals with Disabilities Education Act of 2004
IHE	Institution of Higher Education
LEA	Local Educational Agency
OIG	Office of Inspector General
OMB	Office of Management and Budget
Perkins	Federal Perkins Loan Program
SAO	Texas State Auditor's Office
SEA	State Educational Agency
SFSF	State Fiscal Stabilization Fund
TEA	Texas Education Agency
THECB	Texas Higher Education Coordinating Board
Title I	Title I, Part A of the Elementary and Secondary Education Act of 1965, as amended



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

AUDIT SERVICES
Chicago/Kansas City/Dallas Audit Region

January 27, 2010

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Dear Sirs:

This **final audit report** presents the results of our audit of the systems of internal control over selected American Recovery and Reinvestment Act of 2009 funds in the State of Texas.

Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken will be made by the appropriate Department of Education officials in accordance with the General Education Provisions Act.

If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Education Department official, who will consider them before taking final Departmental action on this audit.

Thelma Meléndez de Santa Ana, Ph.D.
Assistant Secretary
U.S. Department of Education
Office of Elementary and Secondary Education
400 Maryland Ave., S.W.
Washington, DC 20202

It is the policy of the U.S. Department of Education to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within **30 days** would be appreciated.

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

Sincerely,

/s/

Gary D. Whitman
Regional Inspector General for Audit

Systems of Internal Control Over Selected ARRA Funds in the State of Texas

Control Number ED-OIG/A06J0013

PURPOSE

The American Recovery and Reinvestment Act of 2009 (ARRA) places a heavy emphasis on accountability and transparency. Federal agencies and others who are affected by ARRA have the responsibility to ensure that ARRA funds reach intended recipients and achieve intended results. This includes effectively implementing and controlling funds at the Federal, State, and local levels; ensuring that recipients understand requirements and have proper controls in place over the administration and reporting of ARRA funds; and promptly identifying and mitigating instances of fraud, waste, and abuse of the funds. Proper systems of internal control are essential for ensuring ARRA funds are administered properly and used in ways that coincide with the requirements of ARRA.

The purpose of our audit was to determine whether the Texas Education Agency (TEA), other State of Texas agencies, and selected LEAs charged with responsibility for overseeing ARRA funds had designed systems of internal control that are sufficient to provide reasonable assurance of compliance with applicable laws, regulations, and guidance. Our audit covered TEA's and other State of Texas agencies' designs for systems of internal control over the administration and use of ARRA funds as of September 30, 2009.

We assessed the design of State-level internal control that TEA, the Texas Department of Assistive and Rehabilitative Services (DARS), the Texas Higher Education Coordinating Board (THECB), and the State of Texas Governor's Office (Governor's Office) planned to use in administering funds received under ARRA. We assessed the design of internal control over the administration of ARRA funds for Title I, Part A of the Elementary and Secondary Education Act of 1965, as amended (Title I); Part B of the Individuals with Disabilities Education Act, as amended (IDEA); the Vocational Rehabilitation Act; and the State Fiscal Stabilization Fund (SFSF) programs. We assessed the design of State-level internal control related to data quality, cash management, and subrecipient monitoring. In addition, we assessed the design of control for the three areas listed above and use of funds at three local educational agencies (LEAs): Dallas Independent School District (DISD), Fort Bend Independent School District (Fort Bend), and Cleburne Independent School District (Cleburne).

RESULTS

The State of Texas has been proactive in its efforts to ensure the proper administration of ARRA funds. The Texas State Auditor's Office (SAO) is hiring additional staff to handle the anticipated increase in audit effort. TEA has created a task force that is responsible for overseeing ARRA funds. The 22-member Commissioner's Task Force on Federal Stimulus and Stabilization is composed of TEA managers. The chairman of the task force, with assistance from the executive committee, is charged with coordinating agency plans in response to Federal legislation. In addition, TEA is hiring additional personnel to conduct subrecipient monitoring of LEAs receiving ARRA funds.

Because ARRA was in its early stages, THECB, TEA, and the LEAs had not completed designing systems of internal control that are sufficient to provide reasonable assurance of recipient compliance with applicable laws, regulations, and guidance. During our audit, we identified preliminary issues that we brought to the attention of THECB, the Governor's Office, and two LEAs. As a result of the issues we raised during our audit and guidance disseminated by the Office of Management and Budget (OMB) and U.S. Department of Education (Department), THECB, the Governor's Office, and the LEAs made changes to their systems of internal control. For example, the Governor's Office had not designated a State agency to administer the SFSF Government Services fund. The Governor's Office subsequently designated THECB to administer the Government Services fund. Also, THECB decided to use the reimbursement method, which aligns with current procedures at the THECB for the fiscal administration of Federal awards.

However, THECB's, TEA's, and the LEAs' systems of internal control still could be improved so they provide reasonable assurance of subrecipient compliance with applicable laws, regulations, and guidance. We concluded that, as of September 30, 2009—

- THECB could improve its monitoring of subrecipients and their collection and reporting system to support the reporting of ARRA data to ensure compliance with ARRA reporting requirements.
- TEA could improve its oversight to ensure LEAs' compliance with ARRA requirements.

We provided a preliminary version of this final audit report to the Governor's Office, THECB, DARS, and TEA for review and comment on December 1, 2009. The Governor's Office provided consolidated comments on December 16, 2009. The Governor's Office did not fully agree with our findings and recommendations because our work was performed at an early phase in the ARRA process, and the audit did not reflect many of the current structures established to ensure proper administration and monitoring of ARRA funds.

Based on the comments, we modified our Finding No. 1 and deleted a recommendation to develop and implement monitoring procedures. The Governor's Office comments are summarized at the end of each finding. The entire narrative of the Governor's Office comments is included as an Enclosure to this report.

FINDING NO. 1 — THECB Could Improve Its Monitoring of Subrecipients and Its Collection and Reporting System to Support the Reporting of ARRA Data to Ensure Compliance with ARRA Reporting Requirements

THECB was not prepared to monitor the additional SFSF Government Services funds or report accurate data given its increase in oversight responsibility. At the time of our audit, the THECB was preparing to administer approximately \$80 million in SFSF Government Services funds as part of an incentive grants program for institutions of higher education (IHE). In an August 28, 2009, memorandum, the Governor's Office identified THECB as the administrator of the more than \$723 million in SFSF reserved for government services. With the addition of the ARRA SFSF programs, THECB's responsibility increased significantly with the additional IHEs that will receive SFSF and with various other entities, outside the education field, that will receive SFSF Government Services funds.

THECB Needed to Modify its Policies and Procedures to Ensure Adequate Oversight of Recipients of SFSF Government Services Funds

We concluded that the procedures that THECB had in place as of September 30, 2009, to monitor recipients of SFSF Government Services funds might not provide reasonable assurance that ARRA funds are safeguarded. THECB management informed us that it is committed to ensuring that adequate resources are available to monitor funds. However, THECB previously administered only one Federal program, the Federal Perkins Loan Program (Perkins). Only about 50 institutions participate in the Perkins program. With the addition of the ARRA SFSF program, THECB's responsibility increased significantly. Additional IHEs and various other entities outside the education field, such as the Commission on the Arts and the Historical Commission, now will receive SFSF Government Services funds. THECB was in the process of developing a comprehensive ARRA application for the IHEs receiving SFSF funds. THECB also planned to use its current process for monitoring the Perkins program to monitor the ARRA funds at IHEs. However, as of September 30, 2009, the process had not been modified to cover non-educational entities that will receive ARRA SFSF Government Services funds.

The Education Department General Administrative Regulations (EDGAR) contain provisions requiring States to monitor subrecipients to ensure compliance with applicable Federal requirements. According to 34 Code of Federal Regulations (C.F.R.) § 80.40(a),¹ "Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity." The Department reiterated the monitoring requirements for SFSF funds in an August email to States.

Subsequent to our audit, THECB established policy and procedures to ensure adequate oversight of all subrecipients receiving ARRA SFSF Government Services funds. The policies and procedures cover eligible IHE, community and junior colleges, State agencies, and non-profit entities. The monitoring process that THECB established includes multiple elements but is not limited to: (1) advising subrecipients of requirements and providing the most current information available to the subrecipients; (2) monitoring the costs and activities of the subrecipients, as appropriate; (3) conducting subrecipient monitoring activities during pre-payment reviews, desk

¹ All regulatory citations are to the January 1, 2008, version unless otherwise noted.

reviews, audits, and on-site monitoring visits; (4) monitoring subrecipients to assure that invoices and progress reports are submitted in a timely manner; and (5) questioning costs that differ materially from the approved budget or that appear unusual or unallowable and withholding payment until resolved. THECB officials also informed us that the ARRA grant award contracts will specify that grantees are required to submit monthly programmatic data and fiscal reimbursement requests. Recipients will undergo desk reviews that consist of analysis of these reported monthly programmatic data and fiscal reimbursement requests. If exceptions are noted, THECB will bring the exceptions to the attention of institutions for necessary explanations.

THECB Needs to Improve Its Internal Control Over ARRA Data Reporting

THECB's collection and reporting system needs to be improved to support the reporting of ARRA data. THECB planned to require subrecipients to electronically submit the required Section 1512 of Division A of ARRA² data elements using an Excel spreadsheet. THECB will collect, compile, and report ARRA data from subrecipients related to SFSF Government Services funds. Though THECB had not completed the modifications to combine the information from the various sources, its management informed us that it is committed to ensuring that data collected by the THECB are necessary, verifiable, timely, and meet the needs of the public.

According to THECB officials, the comprehensive ARRA application will identify the necessary reporting elements, and the agency has a secure data transmittal site for receiving and sending this information to the subgrantees. However, at the time of our audit, THECB had not yet developed the criteria or methodologies that subgrantees should use to estimate the number of jobs created and retained as a result of ARRA funds. THECB informed us that criteria and methodologies are currently being developed for assessing attainment of these estimates by its subrecipients.

THECB planned to: (1) monitor subrecipients' data collection efforts relating to the ARRA reporting requirements; (2) use a status list to monitor data submissions and certifications with data reports currently in use; and (3) require its subrecipients to certify that the data provided are complete, accurate, and reliable. However, at the time of our audit, THECB was still developing a schedule for gathering reports and related documentation on ARRA expenditures and program performance from the subrecipients.

According to Section 1512 (c) of the ARRA, each recipient that receives ARRA funds from a Federal agency shall submit a report to that agency that contains, among other items: (1) the total amount of ARRA funds received from the agency, (2) the amount of ARRA funds that were expended or obligated for projects or activities, (3) a detailed list of all projects or activities for which ARRA funds were expended or obligated, and (4) an estimate of the number of jobs created and retained by the project or activity. In addition, 34 C.F.R. § 80.20(a) requires that fiscal control and accounting procedures of the State and its subgrantees must permit preparation of reports required by statute and permit the tracing of funds to a level of expenditures adequate to establish that funds have not been misused.

² All subsequent section references to ARRA in this report are to Division A.

Recommendations

We recommend that the Assistant Secretary for Elementary and Secondary Education require the Governor's Office to instruct THECB to —

- 1.1 Develop or modify its data collection system to reflect the additional reporting requirements of ARRA;
- 1.2 Monitor and verify the subrecipients' data collection efforts relating to the reporting requirements; and
- 1.3 Develop criteria and methodologies for entering and reporting on Section 1512 data elements.

Governor's Office Comments

While the Governor's Office did not disagree with our finding, it pointed out that, at the time of the audit, THECB had not awarded any ARRA funds and was still preparing subrecipient monitoring and reporting processes. Therefore, the findings do not accurately reflect THECB's recently established monitoring and reporting processes. According to the Governor's Office, THECB management has acquired the resources to administer and monitor the SFSF Government Services funds assigned to the agency by the Governor's Office. Specifically, THECB established an ARRA Grants Program office and staffed it with five full-time equivalents who have the combined experience and skill sets required to monitor subrecipients and their collection and reporting systems to ensure compliance with ARRA.

Subsequent to the audit, THECB established policies and procedures to ensure adequate oversight of all subrecipients receiving ARRA SFSF Government Services funds, including eligible IHE, community and junior colleges, State agencies, and non-profit entities. It also conducted a training seminar in September 2009 to ensure eligible entities were aware of ARRA guidelines. THECB established an application process for Government Services funds. The process requires potential recipients to undergo an application and notice of grant award process and to report monthly regarding their grant awards.

For the original Recommendation 1.1, relating to the development and implementation of monitoring procedures that address ARRA requirements, the Governor's Office stated that, since the OIG's review, THECB has established monitoring and reporting processes. Therefore, the finding does not accurately reflect the current situation. THECB has developed and implemented procedures designed to perform stewardship activities for its ARRA SFSF-Government Services fund awards.

For the original Recommendation 1.2 (now Recommendation 1.1), the Governor's Office stated that THECB is committed to ensuring that data collected by THECB are verifiable and timely to meet the needs of the public. This is consistent with a long history of data collection for both federally supported career and technical programs and for State accountability programs. THECB has developed systems and safeguards to ensure data collection. Prior to the disbursement of ARRA funds, grantees are required to submit an application for funds to THECB, which requires the collection of all relevant data elements required for ARRA Section 1512 quarterly reporting.

In addition, THECB currently is conducting a comprehensive review of ARRA and Federal agency reporting requirements. If additional requirements are identified through this process, the current reporting templates provided on the THECB ARRA Web site will be modified to incorporate any additional elements for subrecipient reporting. Existing internal systems that support THECB grants management activities are being modified and tested in order to meet short timelines for implementation.

For the original Recommendation 1.3 (now Recommendation 1.2), the Governor's Office stated that THECB has processes to ensure the activities funded by ARRA SFSF Government Services funds will be monitored on a monthly basis as part of the comparison of grant expenditures. The monitoring will include a combination of desk reviews and on-site visits to subrecipients using approved sampling techniques. Subrecipients are required to provide both a progress report (which includes required Section 1512 reporting data elements) and a budget report on a monthly basis. The subrecipient inbound reports will be compared for accuracy to fiscal reports submitted monthly for cost reimbursement. In addition, THECB will verify the information by sampling techniques accepted by its internal audit department.

For the original Recommendation 1.4 (now Recommendation 1.3), the Governor's Office stated that THECB is developing and implementing agency-wide ARRA reporting requirements. These include (1) processes to collect, review, and report all required data elements in Section 1512; (2) a plan or method to ensure the accuracy, completeness, and timely reporting of the required data; (3) methodology by which subrecipients are to estimate the number of jobs created or retained to ensure ARRA subrecipients report consistent and reliable job number data; and (4) performance of data quality reviews for material omissions or significant reporting errors, or both, make appropriate and timely corrections to subrecipient data; and work with subrecipients to address data quality issues.

OIG Response

After reviewing the information provided by the Governor's Office, we modified Finding No. 1 to reflect the subrecipient monitoring procedures THECB established after September 30, 2009 , and removed the original Recommendation 1.1 (dealing with monitoring procedures). Although THECB is making positive steps toward improving its system of internal control, it had not completed its actions on the other recommendations. Therefore, we did not make any changes regarding those recommendations or the portions of the finding on collecting and reporting of data and ensuring compliance with ARRA reporting requirements.

FINDING NO. 2 — TEA Could Improve Oversight of LEAs to Ensure Compliance with ARRA Requirements

We visited three LEAs (DISD, Fort Bend, and Cleburne) to review the LEAs' systems of internal control over data quality, cash management, subrecipient monitoring, and use of ARRA Title I, IDEA, and SFSF funds. We identified issues at two of the three LEAs. Improved oversight by TEA could reduce the risk of these and other types of issues occurring in the future.

Fort Bend's Accounting System Was Vulnerable to Unauthorized Users

Fort Bend's accounting system was not secure. It allowed unauthorized users to access the system. When Fort Bend installed its accounting system, the security features were not fully engaged.³

According to 34 C.F.R. § 80.20(a), a State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State and its grantees must be sufficient to permit the preparation of required reports and permit the tracing of funds to a level of expenditures adequate to establish that funds have not been used in violation of applicable statutes and regulations.

Fort Bend has been allocated more than \$18 million in ARRA funds. An unsecure accounting system could lead to unauthorized users accessing the LEA's accounting system and jeopardizing ARRA funds. Unauthorized users could misuse or misappropriate ARRA funds or even change accounting records so that they are no longer an accurate depiction of ARRA expenditures.

DISD Took Corrective Action on Issues We Identified

During our review of DISD's system of control over ARRA funds, we identified two issues. DISD did not have adequate written procedures for: (1) monitoring its schools that are receiving ARRA funds and (2) implementing "supplement not supplant" procedures. Subsequent to our fieldwork, DISD officials corrected the two issues.

Recommendations

We recommend that the Assistant Secretary for Elementary and Secondary Education require TEA to instruct—

- 2.1 Fort Bend to implement accounting system security features and assign appropriate levels of access and restrictions to district personnel; and
- 2.2 All LEAs about the importance of computer security.

Governor's Office Comments

For Recommendation 2.1, the Governor's Office stated that Fort Bend is in the process of upgrading its software program, and security will be the top priority. User access will be assigned by role rather than by individual. The business office will be working closely with information services staff in the assignment of security to ensure that Fort Bend has adequate separation of duties and that staff have access only to needed areas.

For Recommendation 2.2, the Governor's Office stated that TEA has emphasized, and will continue to emphasize, to the LEAs the importance of computer security. Throughout the Financial Accountability System Resource Guide, TEA discusses the importance of computer security and protecting the district's funds and records. TEA will send out correspondence to all

³ This issue also was identified by the LEA's independent public accountant.

LEAs reminding them of the importance of secure fiscal control and accounting procedures to ensure that unauthorized users cannot access their accounting system and jeopardize ARRA funds.

OIG Response

Because actions responsive to the recommendations have not been completed at this time, we did not make any changes to the finding or the recommendations.

OTHER MATTERS

Texas Legislature Passed a Pay Raise Contingent on Receipt of SFSF Funds

The SFSF program is a one-time ARRA appropriation of \$48.6 billion awarded to States to help stabilize State and local government budgets to minimize reductions in education and to avert cuts and retain teachers. The Department determined that \$3.25 billion of the SFSF funds was available to the State of Texas to allocate to its LEAs. Departmental guidance on the SFSF program, issued in April 2009, states that neither the Governor nor the SEA may mandate how an LEA will or will not use the SFSF funds, even though the State determines the allocation of SFSF funds to the LEAs.

The State of Texas submitted its SFSF application to the Department on July 1, 2009. In its application, the State noted that the Texas legislature appropriated \$3.25 billion in SFSF funds through House Bill 3646 (HB 3646), enacted on May 26, 2009. HB 3646 mandated a pay raise for each classroom teacher and full-time speech pathologist, librarian, counselor, and nurse employed at an LEA in school year 2009-2010. Section 95 of HB 3646 states that the mandated pay raises are “expressly contingent” on whether Texas’s commissioner of education (commissioner) determines that the pay raises are allowable uses of Federal funds under ARRA. On July 24, 2009, the Department approved the State of Texas’s SFSF application. In an August 6, 2009, letter to school administrators, the commissioner determined that Federal funds received by LEAs under ARRA may be used for the pay increases required under HB 3646, and the letter triggered the requirement for LEAs to provide pay increases to certain employees.

The State was aware of Department guidance prohibiting it from mandating the use of SFSF funds and included a statement in its SFSF application, submitted on July 1, 2009, that LEAs have discretion as to which funds (State, local, or SFSF) to use to cover the pay raises. However, LEAs did not receive any additional State funds for the pay raises under HB 3646. Conversely, in 1999 and 2006, LEAs received State funding for the pay raises mandated by the legislature. Based on declining market projections announced by the Texas Comptroller of Public Accounts, it does not appear likely that much, if any, local funding will be available to pay for the raises. In fact, two of the three LEAs that we visited were working with budget deficits. Officials at one district stated that the “district was directed by the legislature to provide raises to ‘scheduled’ employees, and it has certainly contributed to our deficit situation.” The officials at another district did not believe that they had any discretion in funding sources for the raises. TEA estimated that \$481 million in SFSF funds will be used to cover the mandatory pay raises under HB 3646 for school year 2009-2010.

It is unclear whether Texas’s mandatory across-the-board pay raises were consistent with ARRA and Departmental requirements. The Department has communicated that the overall goals of

ARRA have been to save jobs and drive reforms. The Department's April 2009 guidance states that ARRA funds may be used for activities such as paying the salaries of administrators, teachers, and support staff. A September 4, 2009, press release by the Department states that ARRA funds may be used as resources to attract, reward, and retain highly effective teachers in hard-to-staff schools. In Texas's case, the legislation provided for mandatory across-the-board pay raises that were contingent on ARRA funding. The raises were not designed to save jobs or retain particular teachers in particular schools. Unless additional State funds or other Federal funds are made available to cover the pay raises at the LEA level, ARRA will be the source of funds for the mandatory pay raises.

Governor's Office Comments

The Governor's Office disagreed with our position and stated that the State's approved application for SFSF stated that LEAs are not required to use ARRA funds to pay for salary increases detailed in HB 3646. Under the provisions of HB 3646, LEAs are free to use local, State, or Federal funds to pay for salary increases. Although HB 3646 stated that salary increases were contingent on the Department's approval of the State's application for ARRA funding, the legislation did not direct LEAs to use ARRA funding to pay for the salary increases. Despite the misinformed statements of the LEA questioned by ED-OIG, LEAs were clearly notified that salary increases may be funded by ARRA or local or State or other Federal funds.

In July 2009, TEA issued written strategic guidance to LEAs regarding SFSF funding. The guidance included a discussion of the HB 3646 pay raises: "The pay raise required under the bill may be funded using State Fiscal Stabilization Fund (SFSF), state or local funds. However, there is no requirement under HB 3646 that SFSF funds be used to fund these salary increases." This point also was included in a July 30, 2009, letter to LEA administrators. Similar language was used in an August 6, 2009, communication to LEA administrators: LEAs may use ARRA funds received as they see fit, as long as they comply with Federal and State law and reporting and auditing requirements.

With regard to OIG's concern that these salary increases were not consistent with the Department's press release encouraging the use of SFSF funds for targeted schools or teachers, the Governor's Office points out that this press release was issued in September 2009, 3 months after the enactment of HB 3646. In addition, the press release encourages, but does not require, SFSF funds to be spent on the aforementioned purposes. Under ARRA, LEAs alone determine how to spend SFSF funds, and the Department's press release was merely guidance. Texas has encouraged LEAs to spend SFSF and other ARRA monies consistently with U.S. Department of Education guidance. Both the July 30, 2009, letter to LEAs and the July 2009 guidance on SFSF encouraged LEAs to use funds toward the four reform areas established by the Department. Furthermore, Texas LEAs were required to outline in their SFSF grant applications how SFSF funds would be used to promote the four reform areas.

OIG Response

We did not change this section based on the Governor's Office comments. The legislation does not mention that these raises are intended to save jobs or retain particular teachers in particular schools. Section 95 of HB 3646 is a contingency provision which specifies that the pay raise

requirement would not take effect unless it was determined that the pay increases were an allowable use of Federal stimulus funds under ARRA. Based on this provision, the Legislature's intent appears to be that the teacher pay raises be funded with Federal SFSF funds. Given the state of many LEAs' budgets at the time of the legislation's passage, unless additional State funds or other Federal funds were made available to cover the pay raises, ARRA would have to be the source of funds for the mandatory pay raises. ARRA is a one-time infusion of new resources. According to Department guidance, these funds should be invested in ways that do not result in unsustainable continuing commitments after the funding expires. By not providing any State funds for the pay raises, the State or the LEAs, or both, may be required to identify additional funding to support the pay raises after SFSF funds are no longer available.

BACKGROUND

The Texas Governor's Office was allocated \$2.9 billion for SFSF. The State also was allocated \$959 million in ARRA Title I and IDEA funding and \$17.9 million in ARRA Vocational Rehabilitation Act funding. In Texas, the Governor's Office identified THECB as the administrator of the SFSF Government Services funds. Title I, IDEA, and SFSF Education Stabilization Funds are administered by TEA. Vocational Rehabilitation funds are administered by the DARS.

On April 1, 2009, the Department made available 50 percent of the funds for the State's Title I, IDEA, and Vocational Rehabilitation Act programs authorized through ARRA. As of October 8, 2009, TEA had drawn down more than \$29 million in funds. DARS had not drawn down any funds.

Table 1. TEA			
	Allocation Amount	Award Amount	Drawdown Amount
Title I	\$948,737,780	\$474,368,891	\$13,403,670
IDEA	\$969,964,750	\$484,982,375	\$15,823,147
TOTAL:	\$1,918,702,530	\$959,351,266	\$29,226,817

The State's *Application for Initial Funding under the SFSF Program* was approved on July 24, 2009. As of August 28, 2009, the State had not drawn down any SFSF funds.

Table 2. Governor's Office			
	Allocation Amount	Award Amount	Drawdown Amount
Education Stabilization	\$3,250,200,000	\$2,177,682,329	-
Government Services	\$362,592,500	-	-
Total SFSF	\$3,612,792,500	\$2,177,682,329	-

SCOPE AND METHODOLOGY

Our audit covered TEA's and other State of Texas agencies' designs for systems of internal control over the administration and use of ARRA funds as of September 30, 2009. We assessed the design of State-level internal control that TEA, DARS, THECB, and the Governor's Office planned to use in administering funds received under ARRA for Title I, IDEA, Vocational Rehabilitation Act, and SFSF programs. We reviewed State-level control over data quality, cash management, and subrecipient monitoring. In addition, we assessed the design of control for the three areas listed above and the use of funds at three LEAs: DISD, Fort Bend, and Cleburne.

Our audit was limited to assessing the design of internal control. We did not evaluate or test the implementation of the control. Also, during and subsequent to our fieldwork, TEA, DARS, THECB, and the Governor's Office were continuing the process of designing and implementing internal control over their administration of ARRA funds. Thus, the plans and processes reviewed during our audit might be substantially modified or not implemented as designed. In addition, because TEA, DISD, Fort Bend, Cleburne, DARS, and THECB had not used ARRA funds at the time of our audit for Title I, IDEA, Vocational Rehabilitation Act, and SFSF programs, we were not able to test the use of funds and might not have been aware of unique factors related to the administration of ARRA funds during our assessment of the design of internal control. Because of the limited nature of our review and the other factors, there is a more than a remote possibility that other opportunities for improvement in the State and local-level systems of internal control could exist but not be identified by our audit.

To assess the design of internal control, we:

- Reviewed prior single audits and applicable reports issued by the Government Accountability Office, the OIG, and the Texas SAO;
- Gained an understanding of the portions of the law, regulations, Department guidance, OMB Circulars, and contract and grant agreements relevant to the audit's objectives;
- Identified ARRA funds allocated to TEA and the Governor's Office for Title I, IDEA, Vocational Rehabilitation Act, and SFSF programs;
- Interviewed TEA officials responsible for Title I, IDEA, and SFSF;
- Interviewed DAR program officials responsible for the Vocational Rehabilitation Act;
- Interviewed THECB officials involved with the SFSF Government Services funds;
- Obtained and reviewed written policies and procedures related to data quality, cash management, and subrecipient monitoring for Title I, IDEA, the Vocational Rehabilitation Act, and SFSF;
- Obtained and reviewed TEA's monitoring protocols for Title I, IDEA, and SFSF;
- Interviewed officials at the Governor's Office, including the Senior Advisor to the Governor;
- Interviewed officials at the Texas State Comptroller;
- Obtained and reviewed Texas' approved Part I SFSF application and the Texas State Biennial budget; and
- Interviewed school district officials at DISD, Fort Bend, and Cleburne.

We conducted our work from May through September 2009 at TEA, DARS, THECB, and the Governor's Office in Austin, Texas; at Dallas Independent School District in Dallas, Texas; at

Fort Bend Independent School District in Fort Bend, Texas; and at Cleburne Independent School District in Cleburne, Texas. We discussed the results of our audit and recommendations with TEA, DARS, THECB, and the Governor's Office officials on September 3, 2009. In addition, we took into consideration information provided by the Governor's Office on December 16, 2009.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Enclosure:
Governor's Office Comments

NOTE: Recommendation 1.1 was deleted in the final report and subsequent recommendations were renumbered. Therefore, the reference in the comments to Recommendation 1.2 relates to Recommendation 1.1; references to Recommendation 1.3 relate to Recommendation 1.2; references to Recommendation 1.4 relates to Recommendation 1.3 in the final report.



OFFICE OF THE GOVERNOR

RICK PERRY
GOVERNOR

December 16, 2009
Mr. Gary D. Whitman
Regional Inspector General for Audit, Region V
Office of the Inspector General
U.S. Department of Education
400 Maryland Avenue, Southwest
Washington, D.C. 20202
RE: Control Number ED-OIG/A06J0013

Dear Mr. Whitman:

Thank you for the opportunity to respond to the Office of the Inspector General's (OIG) findings outlined in your draft report dated December 2009 and titled "Systems of Internal Control over Selected American Reinvestment and Recovery Act (ARRA) funds in the State of Texas." We understand that this report was issued after a preliminary review of internal controls by the OIGs of a number of Texas state agencies and local education agencies (LEAs) receiving funds under ARRA.

As OIG indicated, its review was performed before many of the Texas agencies and LEAs received or disbursed ARRA funding. Because it was performed at such an early date in the ARRA process, the review does not currently reflect many of the structures established to ensure the proper administration and monitoring of ARRA funds. The State of Texas is committed to ensuring that it adheres to the accountability and transparency requirements of ARRA. In June 2009, Governor Perry issued an executive order requiring all state agencies and institutions of higher education to adhere to all federal and state statutes, laws and policies related to ARRA.

Although the review was preliminary, we were encouraged that OIG recognized substantial efforts Texas had already made to ensure accountability and transparency, including the addition of staff in the state auditor's office and the Texas Education Agency (TEA) for monitoring of ARRA recipients, and the TEA Commissioner's Task Force on Federal Stimulus and Stabilization. As you will see by our response, Texas has put structures in place to ensure oversight of these programs.

Mr. Gary D. Whitman
December 16, 2009
Page 2

Included in this letter are responses to OIG's findings and recommendations based on input from TEA, Texas Higher Education Coordinating Board, the Fort Bend Independent School District and the Office of the Governor. We look forward to working with the OIG to ensure that Texas remains in compliance with ARRA requirements.

Sincerely,

/s/

Mike Morrissey
Senior Advisor
Office of the Governor

MM:jwp
Enclosure

FINDING

1. THECB Could Improve Its Monitoring of Subrecipients and Their Collection and Reporting System to Support the Reporting of ARRA data to Ensure Compliance with ARRA Reporting Requirements

RESPONSE

At the time of the preliminary review, THECB had not awarded any ARRA funds and was still preparing subrecipient monitoring and reporting processes. No funds were awarded during the reporting period, which ended September 30, 2009. To date, \$370 million of the total ARRA funding designated to THECB has been awarded. Therefore, the review findings do not accurately reflect THECB's established monitoring and reporting processes. Please see <http://www.thecb.state.tx.us/index.cfm?objectid=-EDA08572-D9A5-77E9-D5F432A2A7EEOD6B> for information about THECB and ARRA.

THECB management has acquired the resources to administer and monitor the State Fiscal Stabilization Fund (SFSF) — Government Services Funds (GSF) assigned to the agency by the Office of the Governor. Specifically, THECB established an ARRA Grants Program office and staffed it with five full-time equivalents (FTEs) with the combined experience and skill sets required to monitor subrecipients and their collection and reporting systems to ensure compliance with ARRA.

If necessary, the ARRA Grants Program office has the capability to rapidly expand its resources with experienced temporary personnel, and is fully supported by existing THECB staff in the areas of finance, legal, strategic planning, external relations and internal audit. THECB staff is experienced in federal grant management and higher education administration, and is dedicated to the transparent and accountable implementation of the ARRA SFSF-GSF subawards. The institutions and agencies that will be receiving ARRA funds through THECB will be held accountable for their projects in all respects. THECB has a strong working relationship with higher education, community colleges and other eligible institutions participating in the GSF program.

Subsequent to the review, THECB established policies and procedures to ensure adequate oversight of subrecipients receiving ARRA SFSF-GSF funding, to include eligible institutions of higher education, community and junior colleges, state agencies, and non-profit entities. It also conducted a training seminar in September 2009 to ensure eligible entities were aware of ARRA guidelines. THECB established an application process for GSF funding, requiring potential recipients to undergo an application and notice of grant award process, and to report monthly regarding their grant awards.

RECOMMENDATION

1.1. Develop and implement monitoring procedures that address ARRA requirements, including those requirements specific to the SFSF program, for all entities receiving the SFSF Government Services Funds

RESPONSE

At the time of the preliminary review, THECB had not awarded any ARRA funds and was still preparing subrecipient monitoring and reporting processes. No funds were awarded during the reporting period ending September 30, 2009. To date, \$370 million of the total ARRA funding designated to THECB has been awarded. Therefore, the review finding does not accurately reflect THECB's established monitoring and reporting processes. Please see <http://www.thecb.state.tx.us/index.cfm?objectid=EDA08572-D9A5-77E9-D5F432A2A7EE0D6B> for information about THECB and ARRA.

THECB has developed and implemented procedures designed to perform the following stewardship activities for its ARRA SFSF-GSF awards:

- a. Advise subrecipients of requirements imposed on them by federal laws, regulations of the flow-down provisions of the prime contract or grant agreement, and any supplemental requirements imposed by THECB dependent on level of risk as determined by THECB. (Please see the ARRA GSF Terms and Conditions and the ARRA GSF Guidelines posted on THECB ARRA web site indicated above.) THECB will continue to provide subrecipients with new information as it becomes available.
- b. Provide the most current information available to describe the federal prime award to each subrecipient, including the Catalog of Federal Domestic Assistance (CFDA) title and number, award name and number, award year, the type of award, and the name of the federal sponsor, as required by OMB Circular A-133.
- c. Monitor the costs and activities of subrecipients as appropriate, to confirm that funding provided to the subrecipient is used for purposes authorized in the negotiated agreement, and that performance goals (scope of work or specific aims) articulated in the scope of work are achieved.
- d. Upon receipt of an unfavorable audit report from a subrecipient, confirm that the subrecipient has taken appropriate and timely corrective action. If a material weakness or other reportable condition exists, monitoring of the subrecipient will be more frequent and appropriate management actions will be taken.
- e. Require each subrecipient to permit the sponsor and/or the THECB and its auditors to have access to the subrecipient's pertinent records and financial statements, as necessary.
- f. Confirm that subrecipients expending \$500,000 (for fiscal years ending after December 31, 2003) or more in federal awards during the subrecipient's fiscal year are compliant with OMB Circular A-133 audit requirements. Identify any material weaknesses or reportable conditions that result from the A-133 audit.
- g. Conduct subrecipient monitoring activities during pre-payment reviews, desk reviews, audits, and on-site monitoring visits, that will include, but not be limited to:
 - 1) Pre-payment review of invoices received from the subrecipient for allocability, allowability and reasonableness of costs and that charges are within the period of performance of the prime award. Subrecipient invoices will include sufficient detail to determine how awarded funds are being used. ARRA administrative unit reviewers will coordinate closely with the ARRA Grants Director in order to determine that costs are appropriate for the subaward.

- 2) Monitoring subrecipients to assure that invoices and progress reports are submitted in a timely manner.
- 3) Questioning costs that differ materially from the approved budget or that appear unusual or unallowable, and withhold payment until a satisfactory explanation is received.
- 4) Ensure that final invoices are identified as such, and assist as needed in completing project closeout requirements in accordance with federal award terms. Payments will not be approved until aggregated reported expenditures are compared to the approved budget costs for each cost category.
- 5) Managing accurate and timely payment of all invoices. The invoice will be reviewed to ensure that the invoice number is correct, the amount invoiced is within the approved total cost of the subrecipient agreement, costs have been incurred within the subaward period, and final invoices are submitted within 60 days of the termination of the subaward.

RECOMMENDATION

1.2. Develop or modify its data collection system to reflect the additional reporting requirements of ARRA

RESPONSE

At the time of the review, THECB had not awarded any ARRA funds and was still developing data collection system processes. No funds were awarded during the reporting period ending September 30, 2009. To date, \$370 million of the total ARRA funding designated to THECB has been awarded. Therefore, the review finding does not accurately reflect THECB's ARRA established data collection systems. Please see

<http://www.thecb.state.tx.us/index.cfm?objectid=EDA08572-D9A5-77E9-D5F432A2A7EE0D6B> for information about THECB and ARRA.

THECB is committed to ensuring that data collected by THECB is verifiable and timely to meet the needs of the public. This is consistent with a long history of data collection for both federally supported career and technical programs, and for state accountability programs. THECB has developed systems and safeguards to ensure data collection. Prior to disbursement of ARRA funds, grantees are required to submit an application for funds to THECB, which requires the collection of all relevant data elements required for ARRA Section 1512 quarterly reporting. These applications require the entity to agree to provide accurate and timely data. In addition, THECB is currently conducting a comprehensive review of ARRA and federal agency reporting requirements. If additional requirements are identified through this process, the current reporting templates provided on the THECB ARRA web site will be modified to incorporate any additional elements for subrecipient reporting. Existing internal systems that support THECB grants management activities are being modified and tested in order to meet short timelines for implementation. THECB has a secure web portal for receiving, sharing and sending data to external users (subrecipients), and written procedures are being established that provide quality control of all data collected and reported.

1.3. Monitor and verify the subrecipients' data collection efforts relating to the reporting requirements

RESPONSE

At the time of the review, THECB had not awarded any ARRA funds and was still developing data collection system processes relating to reporting requirements. No funds were awarded during the reporting period ending September 30, 2009. To date, \$370 million of the total ARRA funding designated to THECB has been awarded. Therefore, the review finding does not accurately reflect THECB's ARRA established data collection efforts. Please see <http://www.thecb.state.tx.us/index.cfm?objectid=EDA08572-D9A5-77E9-D5F432A2A7EE0D6B> for information about THECB and the ARRA.

THECB has processes to ensure the activities funded under the ARRA SFSF-GSF will be monitored on a monthly basis as part of the comparison of grant expenditures. The monitoring will include a combination of desk reviews and on-site visits to subrecipients using approved sampling techniques. Subrecipients are required to provide both a progress report (which includes required 1512 reporting data elements) and a budget report on a monthly basis. The subrecipient inbound reports will be compared for accuracy to fiscal reports submitted monthly for cost reimbursement. In addition, THECB will verify the information by sampling techniques accepted by our internal audit department.

THECB is responsible for verifying data elements by reviewing the completed Section 1512 report against supporting records. Responsibilities include, but are not limited to:

- a. Collecting, reviewing and staying current on all applicable policies related to Section 1512 (e.g., statewide policies, agency specific policies, OMB policies and federal grantor agency policies) so that the agency preparer is reporting data elements in a manner consistent with relevant policies.
- b. Using an agency reviewer checklist, conduct a review of the Section 1512 report.
- c. Documenting exceptions resulting from review of the agency approval, data exception and remediation plans. Exceptions will be described either in quantitative or qualitative terms so the significance or materiality of the exception is understood.
- d. Summarizing the exceptions noted by award/project on the agency approval, data exception and remediation plans to the agency deputy commissioner for review and certification.
- e. Data quality associated with the American Recovery and Reinvestment Act will be taken into consideration in conducting the review process. The following OMB documents are relevant: Implementing Guidance for the Reports on Use of Funds Pursuant to the American Recovery and Reinvestment Act of 2009, June 22, 2009, and Assessing the Reliability of Computer-Processed Data, July 2009, External Version I.

RECOMMENDATION

1.4. Develop criteria and methodologies for entering and reporting on Section 1512 data elements

RESPONSE

At the time of the review, THECB had not awarded any ARRA funds and was still developing data collection system processes relating to reporting requirements. No funds were awarded during the reporting period ending September 30, 2009. To date, \$370 million of the total ARRA funding designated to THECB has been awarded. Therefore, the review finding does not accurately reflect THECB's ARRA established methodology for entering and reporting Section 1512 data. Please see <http://www.thecb.state.tx.us/index.cfm?objectid=EDA08572-D9A5-77E9-D5F432A2A7EE0D6B> for information about THECB and ARRA.

THECB is developing and implementing the following agency-wide ARRA reporting requirements:

- a. Processes to collect, review and report all required data elements in Section 1512.
- b. A plan or method to ensure the accuracy, completeness and timely reporting of the required data.
- c. Methodology by which subrecipients are to estimate the number of jobs created or retained to ensure ARRA subrecipients report consistent and reliable job number data.
- d. Perform data quality review for material omissions and/or significant reporting errors, make appropriate and timely corrections to subrecipient data, and work with subrecipients to address data quality issues.

THECB is responsible for preparing the prime recipient Section 1512 report. Because no funds were disbursed during the reporting period that ended September 30, 2009, the reporting period ending December 31, 2009, will be the first period for which THECB prepares the prime recipient 1512 report including information from subrecipient IHEs and state agencies. THECB will perform several activities, including, but not limited to:

- a. Collecting, reviewing and staying current on all applicable policies related to Section 1512 (e.g., statewide policies, agency specific policies, OMB policies and federal grantor agency policies) to ensure reports are consistent with all applicable policies.
- b. Obtaining, reviewing and reconciling data provided to THECB from subrecipients.
- c. Collecting all necessary data from subrecipients/vendors to complete the Section 1512 report.
- d. Conducting a review of the data collected from the subrecipients/vendors to ensure the application of policies and guidance (e.g., measurement of jobs created and retained) are consistent.
- e. Communicating data exceptions or differences noted to the subrecipient/vendor so that the appropriate remediations can be made.
- f. Conducting follow-up procedures as well as reviews of updated data provided by the subrecipients/vendor to ensure the data exceptions were appropriately addressed.

- g. Completing the 1512 reporting template.
- h. Conducting a completeness and accuracy review of the completed Section 1512 report prior to submittal.
- i. Preparing and retaining all necessary supporting schedules and documentation.
- j. Establishing a remediation plan, based on recommendations from the agency reviewers or others, for each exception noted.

FINDING

2. TEA Could Improve Oversight of LEAs to Ensure Compliance with ARRA Requirements

RESPONSE

To receive ARRA funding, LEAs must apply to TEA. An LEA's application must provide assurances to TEA that the LEA's fiscal control and accounting procedures permit the tracing of funds to a level of expenditure adequate to establish that funds have been used in accordance with the approved grant application. To review the application for the ARRA programs reviewed by ED-OIG, please visit

<http://burleson.tea.state.tx.us/GrantOpportunities/forms/GrantProgramSearch.aspx>.

The applicant must maintain effective control over and accountability for all funds, property and other assets. LEAs have been provided with extensive training and information on required actions LEAs must take to comply with the ARRA reporting and compliance. To view a TEA LEA webinar please visit <http://www.tea.state.tx.us/webinar.aspx>.

In addition, the TEA established a Special Monitoring Unit section within the Division of Financial Audits. The section was created specifically to carry out oversight responsibilities of subrecipient use of ARRA funded grants. The section consists of experienced audit staff members including five additional auditors.

During its review, OIG found that the Fort Bend Independent School District's accounting system was not secure, as it allowed unauthorized users to access the system. An insecure accounting system could lead to unauthorized users accessing the local education agency's accounting system and jeopardizing ARRA funds.

OIG made two recommendations related to this finding.

RECOMMENDATION

2.1. Implement accounting system security features [at Fort Bend ISD] and assign appropriate levels of access and restrictions to district personnel

RESPONSE

Fort Bend ISD is in the process of upgrading its software program and security will be the top priority. User access will be assigned by role rather than by individual. The business office will

be working closely with information services staff in the assignment of security to ensure that they have adequate separation of duties and that staff only have access to needed areas.

RECOMMENDATION

2.2. Instruct all LEAs about the importance of computer security

RESPONSE

The agency has emphasized and will continue to emphasize to the LEAs the importance of computer security. Throughout the Financial Accountability System Resource Guide the agency discusses the importance of computer security and protecting the district's funds and records. The agency will send out correspondence to all LEAs reminding them of the importance of secure fiscal control and accounting procedures to ensure that unauthorized users cannot access their accounting system and jeopardize ARRA funds. Please see <http://www.tea.state.tx.us/index4.aspx?id=1222> for a copy of this guide.

OTHER MATTERS

Texas Legislature Passed a Pay Raise Contingent on Receipt of SFSF Funds

OIG identified a concern with a pay raise included in Texas House Bill 3646, signed into law on June 19, 2009. This legislation provided for mandatory pay raises for many local education agency (LEA) staff, provided that TEA was able to confirm that such raises would be an acceptable use of ARRA funds assigned to the district. Based on the fact that this legislation did not specifically designate certain funds for these raises, that the raises are effective provided ARRA may be used for them, and the fact that one district interviewed indicated that they "did not believe they had any discretion in the funding sources for the raises," OIG indicated that these raises were contrary to April 2009 Department of Education guidance which indicates that the state may not mandate how an LEA will use SFSF funds.

In addition, OIG expressed concern that these raises were not consistent with a September 2009 press release by the department that encourages ARRA funds to be used as "resources to attract, reward, and retain highly effective teachers in hard-to-staff schools." Because these raises were not focused on specific schools or teachers, OIG expressed concern that the raises were inconsistent with this guidance.

RESPONSE

As specifically stated in the state's approved application for SFSF to the U.S. Department of Education, LEAs are not required to use ARRA funds to pay for salary increases detailed in HB 3646. Under the provisions of HB 3646, LEAs are free to use local, state or federal funds to pay for salary increases. While, under HB 3646, salary increases were contingent on the U.S. Department of Education's approval of the state's application for ARRA funding, the legislation did not direct LEAs to use ARRA funding for the salary increases. Despite the misinformed

statements of the LEA questioned by ED-OIG, LEAs were clearly notified that salary increases may be funded by ARRA or local or state or other federal funds.

In July 2009, TEA issued written strategic guidance to LEAs regarding SFSF funding, including a discussion of the HB346 pay raises. (Please see <http://ritter.tea.state.tx.us/edex/docs/ARRAstrategicGUIDANCE.pdf> for this document.) It specifically states, "The pay raise required under the bill may be funded using State Fiscal Stabilization Fund (SFSF), state or local funds. However, there is no requirement under HB 3646 that SFSF funds be used to fund these salary increases." This point was also included in a July 30, 2009, letter to LEA administrators. (Please see <http://ritter.tea.state.tx.us/haa/formfund073009.html>.) Similar language is used in an August 6, 2009, communication to LEA administrators, as well. (See <http://ritter.tea.state.tx.us/taa/eqs080609.html>.) It is at the discretion of the LEAs to use ARRA funds received as they see fit so long as they comply with federal and state law and reporting and auditing requirements.

With regard to OIG's concern that these salary increases were not consistent with the U.S. Department of Education press release encouraging use of SFSF funds for targeted schools or teachers, this press release was issued in September 2009, three months after the enactment of HB3646, and encourages, but does not require, SFSF funds to be spent on the aforementioned purposes. Under ARRA, LEAs alone determine how to spend SF SF funds, and the U.S. Department of Education press release was merely guidance. Texas has encouraged LEAs to spend SFSF and other ARRA monies consistently with U.S. Department of Education guidance. Both the July 30, 2009, letter to LEAs and the July 2009 guidance on SFSF encourage LEAs to use funds toward the four reform areas established by the U.S. Department of Education. Furthermore, Texas LEAs were required to outline in their SFSF grant applications how SFSF funds would be used to promote the four reform areas. Please see the SFSF grant application at <http://maverick.tea.state.tx.us:8080/Guidelines/SFSF/ARRASF10/SF SF Grant Application.pdf>.

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